

General Information Letter: Gain of a nonresident on stock options treated as compensation for income tax purposes is taxed by Illinois only if it is "paid in this State" under IITA Section 304(a)(2)(B).

April 6, 2006

Dear:

I have reviewed the documentation associated with your 2004 Illinois income tax return and the Form W-2 and supporting schedules supplied to us by your former employer, COMANY, for 2005, in order to determine the proper allocation of the income shown on the 2005 Form W-2. The nature of the inquiry and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

Please attach a copy of this letter to your 2005 return in order to insure proper processing of that return.

Facts

Your 2004 Illinois income tax return indicates that you were a Florida resident, and you have indicated that you continue to be a Florida resident. Accordingly, for purposes of this letter, it is assumed that you are not a resident of Illinois for any portion of 2005.

The 2005 Form W-2 shows total wages of \$1,203,760.70, \$44,512.70 of which is identified as nonqualified plan compensation and the remaining \$1,159,248 is identified as gain from the exercise of employee stock options that is treated as wages. The Form W-2 also identifies the \$1,159,248 as Illinois-sourced wages.

Included with the documentation of your 2004 return is a letter from COMPANY, dated October 6, 2005, stating that the nonqualified plan compensation is being paid to you since your retirement in installments over 13 years.

The schedules provided by COMPANY for the stock options exercised in 2005 show the following amounts:

<u>Grant Date</u>	<u>Exercise Date</u>	<u>Gain Realized</u>
June 24, 1997	May 23, 2005	\$385,035.00
June 23, 1998	January 3, 2005	218,912.50
June 23, 1998	January 3, 2005	218,100.50
June 29, 1999	October 3, 2005	337,200.00
Total		\$1,159,248.00

Included with the documentation of your 2004 return is a letter from COMPANY, dated September 8,

2005, which states that you were employed in Illinois prior to January 1, 1997; from January 1, 1997 through November 9, 2001, you were employed in Europe; and from November 9, 2001, through your retirement on March 1, 2002, you were employed in Illinois.

In a telephone conversation on March 31, 2006, Ms. Z of COMPANY has informed me that the stock options you exercised were granted each year based on your performance in the prior calendar year. Ms. Z also stated that it is the practice of COMPANY to allocate the gains from employee stock options exercised by a retiree to the retiree's state of residence as of the date of his or her retirement.

Response

Under 4 U.S.C. Section 114(a), only the state of residence is allowed to tax retirement income. Section 114(b)(1) defines "retirement income" to include any amount paid out after retirement in installments lasting at least 10 years. Accordingly, Illinois cannot tax the nonqualifying plan compensation paid to you by COMPANY unless you are an Illinois resident.

86 Ill. Admin. Code Section 100.3120(b) provides, in part:

Compensation earned in each past year will be deemed compensation paid in Illinois if the individual's service in such year met the tests set forth in subsection (a) above.

86 Ill. Admin. Code Section 100.3120(a)(1) provides, in part:

Compensation is paid in Illinois if:

- A) The individual's service is localized in Illinois because it is performed entirely within Illinois;
- B) The individual's service is localized in Illinois although it is performed both within and without Illinois, because the service performed without Illinois is incidental to the individual's service performed within Illinois; or
- C) The individual's service is not localized in any state but some of the service is performed within Illinois and either:
 - i) the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within Illinois, or
 - ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in Illinois.

According to Ms. Z, the stock options you exercised on May 23, 2005, were issued to you in 1997 for services rendered by you in 1996, when you were working in Illinois. Accordingly, the \$385,035.00 in gain recognized on that exercise is compensation paid in Illinois and must be allocated to Illinois

by a nonresident. The remaining options exercised in 2005 were issued for services performed after 1996, when you were working in Europe, and are therefore not allocable to Illinois.

Please attach a copy of this letter to your 2005 return in order to allow us to process your return consistent with the facts stated in this letter. Please note that this letter does not state or imply any agreement on our part that any of the facts stated above are correct, and we reserve the right to examine your return and determine if the facts stated above are correct.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 524-3951.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax